

Brooklyn Journal of International Law

Volume 17

Issue 3

Symposium:

Transnational Insolvency: A Multinational View of
Bankruptcy

Article 4

12-1-1991

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Recommended Citation

Jacob S. Ziegel, *Canadian Perspectives on Transborder Insolvencies*, 17 Brook. J. Int'l L. 539 (1991).

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CANADIAN PERSPECTIVES ON TRANSBORDER INSOLVENCIES

Jacob S. Ziegel*

I. PRELIMINARY OBSERVATIONS

Bankruptcies and other forms of insolvency are of major economic and social significance in the Canadian economy. For example, 7,659 business bankruptcies were reported in the calendar year 1987 with total liabilities of 1,781.2 million dollars and an estimated total deficiency of 1,260 million dollars.¹ In the same year there were 24,384 consumer bankruptcies with a total deficiency of 409.4 million dollars.² These figures are incomplete because they do not include the large number of privately and judicially appointed receivers falling outside the insolvency legislation that are appointed each year at the behest of secured creditors to enforce all encompassing security interests given by the debtor in the secured creditor's favor.

Canada has a federal system of government and, under the Canadian constitution,³ paramount power to legislate in matters of bankruptcy and insolvency lies with the federal government. In practice, Canadian courts have tolerated concurrent provincial legislation of a bankruptcy character so long as it does not conflict directly with existing federal provisions.⁴ The federal

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Professor of Law, University of Toronto, Canada. This paper is a moderately revised version of the National Report on Canada prepared by the author for presentation to Section III.A.3 of the 13th International Congress of Comparative Law held in Montreal in August, 1990. The topics covered and the sequence in which they are presented follow those in a questionnaire circulated among the national reporters by the General Reporter for the Section. This also explains the succinctness of the author's style in the survey and the abrupt change in topics.

1. Consumer & Corporate Affairs Canada, *Insolvency Bulletin*, Jan. 1988, at 22-25. The corresponding figures for the calendar year 1990 were: 11,642 business bankruptcies, total liabilities of \$3,342 million, and a total deficiency of \$1,905 million. *Insolvency Bulletin*, Apr. 1991, at 120. The dramatic increase in the number of business bankruptcies between 1988 and 1990 is generally attributed to the economic recession, which affected the central provinces of Canada particularly severely. The total deficiency figure for 1988 and 1990 are only estimates and are based on the Statement of Affairs filed by bankrupts at the beginning of the bankruptcy proceedings. The actual deficiency for each of these years was almost certainly substantially larger.

2. *Id.* This figure does not include "consolidation orders" made under Part X of the Canadian Bankruptcy Act which is referred to hereafter.

3. Constitution Act, R.S.C., ch. 3, § 91 (21) (1982) (Can.).

4. *Robinson v. Countrywide Factors Ltd.* [1978] 1 S.C.R. 753 (Can.); *Paccar Finan-*

bankruptcy and insolvency legislation discussed hereafter applies equally to the common-law provinces and to Quebec, a civil-law jurisdiction. However, provincial private law principles continue to apply in bankruptcy where there are no conflicting statutory provisions.⁵ At the present time, the federal insolvency legislation contains no conflict of laws provisions.⁶ Such questions therefore are also determined by applicable provincial law.

Given the close business and trading ties between Canada and the United States,⁷ insolvency problems frequently arise between the two countries. However, the amount of reported litigation is modest⁸ and in practice experienced bankruptcy practitioners prefer to look for alternative solutions to overcome such difficulties.

II. SCOPE OF CANADIAN INSOLVENCY LEGISLATION

A. *Straight Bankruptcies*

Straight bankruptcies are governed by two Acts, the Bankruptcy Act (Act)⁹ and the Winding Up Act.¹⁰ The Bankruptcy Act is by far the more important of the two Acts and applies equally to natural persons and to corporations.¹¹ In this respect the Canadian Act follows the United States model and not the bifurcated British system.

The current Canadian Bankruptcy Act was first adopted in 1949 and was amended in some important respects in 1965. In 1970 the Report of the Study Committee on Bankruptcy and Insolvency¹² recommended the adoption of a revised Bankruptcy Act in light of the many economic and social changes, nationally and internationally, that had occurred since 1949. A Bill incorporating many of the Committee's recommendations was introduced in 1975, and subsequently reintroduced¹³ on several occa-

cial Services v. Sinco Trucking [1989] 57 D.L.R.4th (Sask. C.A.).

5. Bankruptcy Act, R.S.C., ch. B-3, § 72 (1985) (Can.) [hereinafter Bankruptcy Act].

6. A detailed set of provisions appeared in Bill C-17, which were introduced by the federal government in 1984 as part of a proposed revised Insolvency Act. Like many of its predecessors, Bill C-17 did not proceed beyond the second reading stage.

7. About 70% of Canada's exports go to the United States.

8. Unlike the volume of periodical literature, which is very substantial.

9. Bankruptcy Act, *supra* note 5, at ch. B-3.

10. Winding Up Act, R.S.C., ch. W-11 (1985) (Can.) [hereinafter Winding Up Act].

11. The contrary impression left by the General Reporter's Report is mistaken.

12. 1970 Report of the Study Committee on Bankruptcy and Insolvency, Information Canada, Ottawa 1970.

13. The latest version, Bill C-17, was introduced in 1984. See *supra* note 5.

sions in an amended form in the light of comments and public hearings. Unfortunately none of the bills secured Parliamentary approval. However, in 1984 the present federal government announced its intention to aim instead for an amending Act and struck a committee of experts to recommend what should be included in such an Act. The Committee reported in 1986¹⁴ but, until June 1991, political exigencies and the Parliamentary timetable have delayed introduction of the implementing legislation.¹⁵

The current Bankruptcy Act applies to any person¹⁶ who, at the time an act of bankruptcy¹⁷ was committed, resided or carried on business in Canada. The Act rejects a simple asset test. "Person" is broadly defined¹⁸ as including, *inter alia*, a partnership, an unincorporated association, and a corporation. "Corporation" in turn is equally broadly defined to include any incorporated company "wherever incorporated" that has an office in or carries on business within Canada, but excludes banks, insurance companies, and other financial intermediaries that are regulated by special legislation.

The Winding Up Act is of British origin and was first adopted in 1881¹⁹ at a time when Canada had no general insolvency legislation.²⁰ The Winding Up Act applies, *inter alia*,²¹ to all "trading companies,"²² wherever incorporated, carrying on business in Canada. The single most important conceptual difference between the Winding Up Act and the Bankruptcy Act resides in the office of the functionary appointed to wind up the affairs of the insolvent person. Under the Bankruptcy Act the appointed individual is a trustee in whom legal title to all the

14. *Report of the Advisory Committee on Bankruptcy and Insolvency: Proposed Bankruptcy Act Amendments*, Ottawa, Ministry of Supply & Services (1986) [hereinafter Study Committee Report].

15. Bill C-22, 3d Sess., 34 Parl., 40 Eliz. II, 1991, An Act to enact the Wage Claim Payment Act, to amend the Bankruptcy Act and to amend other Acts in consequences thereof received first reading in the House of Commons on June 17, 1991, and second reading on Oct. 1991. The federal government is aiming for Parliamentary approval of the bill by the end of 1991.

16. See definition of "debtor" in Bankruptcy Act, *supra* note 5, at § 2.

17. "Act of bankruptcy" is defined in Bankruptcy Act, *supra* note 5, at § 42.

18. See Bankruptcy Act, *supra* note 5, at § 2.

19. Winding Up Act, 1881, 44 & 45 Vic., ch. 23 (Eng).

20. Study Committee Report, *supra* note 14, at para. 1.2.05.

21. Winding Up Act, R.S.C., ch. W-11, § 6 (1882) (Can.).

22. Defined somewhat inelegantly by enumeration of many types of specific businesses in Winding Up Act, *supra* note 10, at § 2.

property and assets of the bankrupt is vested.²³ Under the Winding Up Act the individual is the liquidator²⁴ but he is only a representative of the company being wound up and legal title to all its assets remains with the company. This distinction between a trustee and a liquidator has been much emphasized in British and Australasian cases²⁵ and is of great conceptual importance for conflict of laws purposes.²⁶

The availability of the more modern Bankruptcy Act for the administration and distribution of the assets of insolvent business corporations has made the Winding Up Act essentially superfluous and it is little used in practice.²⁷ The Winding Up Act will therefore be largely ignored in the balance of this report.

1. Legislation Concerning the Rehabilitation of Insolvent Persons

The Canadian legislation uses a variety of expressions²⁸ to describe proceedings designed to save an insolvent individual or business from being forced into bankruptcy; the term rehabilitation is used here in a nontechnical sense to encompass all such proceedings.

The Bankruptcy Act contains two rehabilitation procedures. The first (Part III),²⁹ the older of the two, covers a Proposal for a composition, extension of time or arrangement, and applies to both personal and business proposals. In practice it is primarily used for business proposals. A serious shortcoming of Part III is

23. Bankruptcy Act, *supra* note 5, at § 71(2).

24. Winding Up Act, *supra* note 10, at § 23.

25. See *inter alia* New Zealand Loan & Mercantile Agency Co. v. Morrison, 1898 App. Cas. 349, 358 (Eng. P.C. 1897) and, for a more recent example, Judge Hirst's judgment in *Felixstowe Dock & Ry. Co. v. United States Lines Inc.*, [1988] 2 All E.R. 77 (Q.B. 1987). The earlier Commonwealth cases are discussed in BRUCE H. MCPHERSON, *THE LAW OF COMPANY LIQUIDATIONS* 464-66 (3d ed. 1987) [hereinafter MCPHERSON].

26. Curiously the distinction has been more or less ignored in the Canadian cases: it is not clear why, but it may have something to do with the lack of persuasiveness of the distinction in the international arena.

27. A further reason for the obsolescence of the Winding Up Act is that § 213 of the Bankruptcy Act, *supra* note 5, provides that where a petition for a receiving order or an assignment has been filed under the Bankruptcy Act in respect of a corporation, the Bankruptcy Act and not the provisions of the Winding Up Act shall apply to the proceedings, and that where proceedings have been instituted under both Acts proceedings under the Winding Up Act shall abate.

28. *E.g.*, composition, extension of time and arrangement. See Bankruptcy Act, *supra* note 5, at § 2, definition of "Proposal."

29. See Bankruptcy Act, *supra* note 5, at Part III.

that it does not apply to secured creditors,³⁰ which therefore greatly reduces its utility. The second rehabilitative procedure (Part X)³¹ was introduced into the Bankruptcy Act in 1966 to serve the needs of overextended consumers by enabling them to consolidate their debts and to pay them off over a three year period. In practice, many insolvent consumers find it simpler to opt for a straight bankruptcy.

There are two other rehabilitative procedures, but these lie outside the Bankruptcy Act. The first of these, also influenced by British precedents, is the Companies' Creditors Arrangement Act (CCAA).³² The CCAA was first adopted in 1933 to bridge the gap in corporate debt indentures which contain no provisions for making changes in the terms of the indenture by majority decision of the bondholders.³³ The CCAA is restricted to companies which have an outstanding issue of secured or unsecured bonds issued under a trust deed.³⁴ The CCAA³⁵ applies to any company, wherever incorporated, having assets or doing business in Canada, again with the exception of financial intermediaries and other companies regulated by special legislation. Despite its restricted scope, the CCAA has enjoyed a strong revival in popularity during the 1980s, and continues to do so.³⁶ This is attributable to its flexible provisions and to the fact that the CCAA applies to secured as well as unsecured creditors.³⁷

The other rehabilitative procedure is found in section 192 of the Canada Business Corporations Act dealing with "arrangements" between a federally incorporated company and its creditors and/or security holders. Until recently the section was not believed to apply to insolvent corporations but the opposite con-

30. Bankruptcy Act, *supra* note 5, at § 54.

31. See Bankruptcy Act, *supra* note 5, at §§ 217-42.

32. R.S.C., ch. C-36 (1985) (Can.) [hereinafter Companies' Creditors Act].

33. Study Committee Report, *supra* note 14, at para. 1.2.19-21. For a much cited article discussing the origin and structure of the legislation see Stanley E. Edwards, *Reorganizations Under the Companies' Creditors Arrangement Act*, 25 CAN. BAR REV. 587 (1947).

34. Companies' Creditors Act, *supra* note 32, at § 3(a).

35. Companies' Creditors Act, *supra* note 32, at § 2.

36. In particular the requirement in § 2 for a trust deed accompanying the issue of the securities. After a period of initial hesitation Canadian courts largely emasculated the requirement by accepting "instant" trust deeds and securities executed by the debtor shortly before applying for relief under the CCAA. See *Elan Corp. v. Comiskey*, [1991] 1 O.R.3d. 289, 302 (Ont. Ct. App) (Doherty J., dissenting).

37. David H. Goldman, *Reorganizations Under the Companies' Creditors Arrangement Act*, 55 CAN. BKCY. REP. 36 (1985); Goldman, Baird, and Weinczok, *Arrangements Under the Companies' Creditors Arrangement Act*, 1 CAN. BKCY. REP. (3d) 1 (1991).

clusion was reached in Alberta confirmatory hearings involving the reorganization of a major petroleum corporation.³⁸

2. Underlying Philosophy of Canadian Legislation

The Canadian Bankruptcy Act is overwhelmingly distributive and rehabilitative in its goals. The penal aspects are of negligible importance.³⁹ The theoretical goal of the Act is to ensure equal treatment of creditors in the distribution of the net assets of the estate. However, this objective is heavily diluted by the priority accorded secured creditors and preferred creditors⁴⁰ and, to a much smaller extent, by the establishment of a small category of deferred creditors.⁴¹ The impact of the priority creditors is particularly heavy and in practice the dividend paid to unsecured creditors usually only amounts to about five cents in the dollar.

The Bankruptcy Act confers broad discretion on the courts whether or not to discharge an insolvent individual from bankruptcy when all or part of his debts remained unpaid. In practice, Canadian courts exercise their powers very benevolently in the bankrupt's favor.⁴²

3. Juridical Classification and Competence of Courts

The Bankruptcy Act draws no distinction between civil and commercial bankruptcies and this accords with the general absence of a distinction between commercial and civil matters in the common law provinces. Such a distinction does exist under the Quebec civil code but it does not appear to have exerted any influence on the federal legislation.

There are no separate bankruptcy courts for the administration of the federal insolvency legislation. The Bankruptcy Act⁴³ confers jurisdiction on the superior courts in each province and

38. See Simon B. Scott, et al., *The Arrangement Procedure under Section 192 of the Canada Business Corporations Act and the Reorganization of Dome Petroleum Limited*, 16 CAN. BUS. L.J. 296 (1990).

39. See Bankruptcy Act, *supra* note 5, at § 199 (penalties for obtaining credit or carrying on business without disclosure of bankrupt status) and § 200 (failure to keep proper books where the bankrupt person had previously been made bankrupt or had made a proposal).

40. See Bankruptcy Act, *supra* note 5, at § 136(1).

41. Bankruptcy Act, *supra* note 5, at §§ 137-40.

42. For an exposition of the current judicial philosophy, see *Re McAfee*, 49 D.L.R.4th 401 (B.C. Ct. App. 1988).

43. Bankruptcy Act, *supra* note 5, at §§ 183-97.

authorizes the chief justice in each province to nominate or assign judges of the superior court to exercise jurisdiction under the Act.⁴⁴ The Minister of Justice may also authorize a county court or district court judge to exercise jurisdiction under the Act.⁴⁵

4. Jurisdictional Nexus Between Debtor and Insolvency Proceedings

The jurisdictional requirements for the institution of bankruptcy proceedings are modest in number and easily satisfied in practice. First, as previously noted, the debtor must have resided or carried on business in Canada at the time the act of bankruptcy was committed by him.⁴⁶ Second, a debt or debts aggregating 1,000 dollars or more must be owing to the petitioning creditor or creditors. Third, the debtor must have committed an act of bankruptcy within the preceding six months. "Act of bankruptcy" is broadly defined in section 42 and encompasses ten types of situations. The two most commonly invoked in practice are that there is an outstanding execution against the debtor⁴⁷ or that the debtor has generally ceased to meet his liabilities as they become due.⁴⁸

The court is not obliged to grant the bankruptcy petition even where the three jurisdictional requirements have been met.⁴⁹ The court is entitled to decline the petition if "sufficient cause" is shown. In practice this discretion appears to be very sparingly exercised. For example, there is no reported case of the court refusing a bankruptcy petition on the ground that bankruptcy proceedings are already in progress in a foreign

44. Bankruptcy Act, *supra* note 5, at § 185. The delegation of powers to provincially created courts may seem strange to non-Canadian eyes but is readily explicable. Canada has a substantially unitary court structure in which most courts, whether federally or provincially created, apply provincial and federal law. All superior court judges are appointed by the federal government and the Supreme Court of Canada is the ultimate court of appeal on questions of provincial as well as federal law.

45. Bankruptcy Act, *supra* note 5, at § 186. This power is becoming of diminishing importance in light of the merger that has recently taken place in most of the provinces between the superior and district and county courts.

46. Bankruptcy Act, *supra* note 5, at § 2, definition of "debtor." The same requirement applies *mutatis mutandis*, where an "insolvent person" (§ 2) makes an assignment pursuant to § 49 for the general benefit of his creditors.

47. Bankruptcy Act, *supra* note 5, at § 42(e).

48. Bankruptcy Act, *supra* note 5, at § 42(f). See, e.g., *Re Holmes & Sinclair*, 20 C.B.R. 111 (Ont. S. Ct. 1975).

49. Bankruptcy Act, *supra* note 5, at § 43(7).

jurisdiction.

The jurisdictional requirements are even simpler where an insolvent person⁵⁰ wishes to make an assignment for the benefit of his or her creditors. There are no judicial proceedings; instead the insolvent person files an application⁵¹ containing the prescribed particulars with the Official Receiver, who is an administrative official without judicial powers. It would appear that the Official Receiver is obliged to accept the application if it contains the prescribed particulars and the applicant satisfies the requirements of an insolvent person.

5. Effect of Limited Nexus; Status of Domestic and Foreign Creditors

The Canadian legislation imposes no special requirements where the debtor has only a limited nexus with the host jurisdiction. Likewise, Canadian law draws no distinction between domestic and foreign creditors in establishing qualifications for the bringing of a bankruptcy petition,⁵² and it is not uncommon for a foreign creditor to bring such a petition.

6. Jurisdiction Over Assets Located Abroad

Several sections of the Bankruptcy Act make it clear that the bankruptcy order embraces all assets of the debtor wherever they are located. Section 16(3) enjoins the trustee to take possession as soon as possible, of "all" property of the debtor.⁵³ Section 67(c) provides that the property of a bankrupt is divisible among his or her creditors and comprises all property of the bankrupt "wherever situated," at the date of bankruptcy or that may be acquired or may devolve on him or her before discharge. What is striking about these provisions is that they do not appear to give the trustee or the court any discretion in determining whether or not to restrict the trustee's administration of the estate to assets located within Canada.

50. Defined in Bankruptcy Act, *supra* note 5, at § 2.

51. Bankruptcy Act, *supra* note 5, at § 49.

52. Bankruptcy Act, *supra* note 5, at § 2 defines "creditor" as a person having a claim, preferred, secured or unsecured, provable as a claim under the Act.

53. Cf. DUNCAN & HONSBERGER, *BANKRUPTCY IN CANADA* 50 (3d ed. 1961) [hereinafter DUNCAN & HONSBERGER].

7. Admissibility of Foreign Claims

Only in the case of preferred and foreign revenue claims does the Canadian legislation distinguish between domestic and foreign creditors. The definition of creditor in the Bankruptcy Act is quite open-ended⁵⁴ and no special claim procedures are imposed on foreign creditors. Instead, like domestic creditors, they are simply required to prove their claims by completing a proof of claim in prescribed form.⁵⁵ Except as noted below in relation to claims by the state and its organs, claims by foreign creditors are treated in the same ways as claims of domestic creditors.

8. Basic Rules of Priority in Distribution of Assets

The order of priority of claims is as follows: (1) secured creditors; (2) preferred creditors; (3) unsecured creditors; and (4) deferred creditors.⁵⁶ "Secured creditor" is very broadly defined⁵⁷ and would appear to encompass nonconsensual as well as consensual security interests.⁵⁸ The priority accorded secured creditors is of particular significance because of the ease with which consensual security interests can be created under federal and provincial law.

Section 136(1) of the Bankruptcy Act does not restrict preferred claims to the proceeds from the sale of the debtor's assets located within Canada. However, foreign claims treated as preferred under the law under which they were created do not fare as well under the Canadian Act. First, they will not be recognized as preferred unless they fall within one of the recognized categories of preferred claims in section 136(1) of the Bankruptcy Act.⁵⁹ And second, a further restriction is imposed be-

54. See definition of creditor in Bankruptcy Act, *supra* note 5, at § 2.

55. Bankruptcy Act, *supra* note 5, at § 124.

56. Bankruptcy Act, *supra* note 5, at §§ 136-41.

57. See definition of "secured creditor" in Bankruptcy Act, *supra* note 5, at § 2.

58. This appears abundantly from the list of recognized secured claims enumerated in DUNCAN & HONSBERGER, *supra* note 53, at 63-65. There is one important qualification and this is that a provincial legislature cannot transform a claim treated as a preferred claim in Bankruptcy Act, *supra* note 5, at § 136(1) by deeming it to be a secured claim or by deeming the debtor to hold designated funds on trust for the Crown. See *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24 (Can.) and the earlier Supreme Court decisions cited in Justice McLachlin's majority judgment.

59. Writing from an Australian perspective, McPHERSON, *supra* note 25, at ch. 16, argues that foreign preferential claims will be recognized in the forum whether or not they also satisfy the forum's criteria for preferred claims. However, the cases cited by

cause Canadian courts follow the English rule that foreign revenue claims will not be enforced in Canada.⁶⁰ Under exceptional circumstances, the rule may be waived if an undertaking has been given to the foreign court that foreign priorities will be honored in Canada, or where the foreign court has been misled about the status of foreign revenue claims under Canadian law.⁶¹

9. Recognition of Foreign Insolvency Orders in Canada

As previously explained, the Canadian Bankruptcy Act does not contain any rules for the recognition of foreign insolvency decrees. This question is therefore determined by provincial conflict of laws rules. The provincial rules differ as between the common law provinces and the province of Quebec and it will be convenient to keep them separate in the discussion that follows.

10. Position in the Common Law Provinces

The provincial courts have consistently followed the British rule that a bankruptcy or liquidation order issued in the country of the debtor's domicile will be recognized by the forum with respect to the debtor's movables and will entitle the representative to take possession of the property located in the forum and to realize it in accordance with the law under which he was appointed.⁶²

In the case of individual bankrupts, domicile here apparently has the same meaning as for other conflict of laws purposes although there has been little discussion of the issue. For the purpose of corporate bankruptcies and liquidation orders, domicile means the state of incorporation of the debtor company. Again, however, the Canadian courts have had little need to consider alternative criteria as urged by various authors. There is, however, some authority to support the proposition (also accepted in England) that submission to the jurisdiction of

him are inconclusive or can be distinguished on other grounds. See Jacob S. Ziegel, *Jurisdiction to Liquidate Foreign Companies and Extraterritorial Effects of Bankruptcy and Liquidation Orders*, CURRENT DEVELOPMENTS IN INTERNATIONAL BANKING AND CORPORATE FINANCIAL OPERATIONS 326 n.70 (Butterworths 1989) [hereinafter Ziegel].

60. *Government of India v. Taylor*, 1955 App. Cas. 491 (Eng. P.C.); *United States v. Harden*, 1963 S.C.R. 366 Can.

61. *Re Sefel Geophysical Ltd.*, 54 D.L.R.4th 117 (Alta. Q.B. 1988).

62. See inter alia *Williams v. Rice*, [1926] 3 D.L.R. 225 (Man. K.B.); *In Re Eades Estate*, 33 D.L.R. 335 (Man. K.B. (1917)); *Re IIT*, 19 C.B.R. 263 (Ont. S. Ct. 1975); *Pickford v. The Atlantic Transportation Co.*, 40 N.S.R. 237 (Can. 1899).

the foreign court making the insolvency order will be sufficient to justify recognition of the order.⁶³

The rule of recognition is subject to the following qualifications and exceptions:

(a) The recognition does not extend to immovables. This exception was enunciated by the Supreme Court of Canada in an early decision⁶⁴ which has been generally accepted uncritically. However, it appears to be based on faulty reasoning and in principle there is no reason why the foreign representative's status should not be accepted in Canada if a Canadian-appointed representative would have been entitled to claim the immovable property under similar circumstances.⁶⁵

(b) A foreign bankruptcy order, although otherwise entitled to recognition, does not preclude a Canadian court from making a bankruptcy order against the debtor in Canada.⁶⁶ As in England, the theoretical foundation of this well established exception has never been properly articulated or reconciled with the rule of recognition. Unlike British courts, Canadian courts do not insist that an order made in Canada will only be ancillary to the foreign order,⁶⁷ although in practice it may turn out to be so.

(c) The foreign representative cannot impeach prebankruptcy transactions occurring in the forum because they were voidable under the bankrupt's domiciliary law, or attack rights acquired by a third party under the forum's law even though they would not be recognized under the bankrupt's domiciliary law. These well known exceptions are based on the House of Lords' decision in *Galbraith v. Grimshaw*⁶⁸ and, although accepted by commentators as applicable to Canada, they have so far received little judicial attention in Canada. In *Williams v. Rice*,⁶⁹ a Manitoba case, the English decision was apparently

63. *Pitts v. Hill & Hill Truck Line Inc.*, 53 Alta. L.R.2d 219 (Q.B. 1987).

64. *Macdonald v. Georgian Bay Lbr. Co.*, 2 S.C.R. 364 (Can. 1878).

65. See A.D. Grace, *Law of Liquidations: The Recognition and Enforcement of Foreign Liquidation Orders in Canada and Australia — A Critical Comparison*, 35 INT'L & COMP. L.Q. 664, 676-667 (1986); Ziegel, *supra* note 59, at 330-31.

66. *Re E.H. Clarke & Co.*, 3 C.B.R. 593 (Ont. S. Ct. 1923); *Allen v. Hansen*, 18 S.C.R. 667 (Can. 1893).

67. But see *Re National Benefit Assurance Co.*, [1927] 3 D.L.R. 289 (Man. Ct. App. 1927), per Trueman J.A. at 300-02 (Man. Ct. App.) and *cf. Re Breakwater Co.*, 33 O.L.R. 65 (Can. App. Div. 1914). Both cases involved liquidation orders. Different considerations may apply where an application is brought under the Bankruptcy Act.

68. 1910 App. Cas. 508.

69. [1926] 3 D.L.R. 225 (Man. K.B.).

overlooked and in *Re Premium Plywood Products Inc.*,⁷⁰ a British Columbia decision, the trial judge applied the United States provisions on fraudulent preferences with the consent of both parties.

(d) The rule of recognition may not preclude a creditor from bringing an action to enforce a prebankruptcy claim against the bankrupt in Canada. This very dubious exception is based on Mr. Justice Kerwin's decision in *Marine Trust Co. v. Weinig*,⁷¹ and has been followed in subsequent cases.⁷² However, it is untenable in principle and is not consistent with many other decisions,⁷³ including *Galbraith v. Grimshaw*. Therefore, *Weinig* ripe for review and is unlikely to be upheld by higher authority.

(e) A discharge of the bankrupt's debt under the law of the state making the bankruptcy order or, *semble*, a variation in the terms of payment or amount of the debt made pursuant to a reorganization order, are not effective unless the discharge or reorganization is also recognized by the proper law of the debt. The first half of this well known exception is based on the English Court of Appeal's decision in *Gibbs & Sons v. La Société Industrielle et Commerciale des Métaux*.⁷⁴ The second half of the proposition follows logically from *Gibbs* and finds support in the Privy Council's judgment in *New Zealand Loan & Mercantile Agency Co. v. Morrison*.⁷⁵ The decision in *Gibbs* has not attracted much judicial attention in Canada.⁷⁶ It is the contrary decision of the United States Supreme Court in *Canadian Southern Ry. Co. v. Gebhard*⁷⁷ that is better known. The Canadian position remains unsettled and awaits appellate clarification.

(f) The rule of recognition only applies where title to the debtor's assets has been transferred to the foreign representa-

70. 19 C.B.R. 76, 77 (Can. 1975).

71. [1935] 3 D.L.R. 282 (Ont. S.Ct.).

72. See, e.g., *Chieftain Products Inc. v. Coleco Industries Inc.*, Toronto Weekly Court, Dec. 16, 1988.

73. *Pickford v. The Atlantic Transportation Co.*, 40 N.S.R. 237 (1899); *Pitts v. Hill & Hill*, 53 Alta. L.R.2d 219 (Q.B. 1987); *Borden & Elliott v. Winston Industries Inc.*, an unreported decision noted in Ziegel, *supra* note 59, at 344 n.54.

74. 25 Q.B.D. 399 (Eng. 1890).

75. 1898 App. Cas. 349, 359 (Eng. P.C. 1897).

76. But see *Int'l Harvester Co. of Can. Ltd. v. Zarbok*, 1918 3 W.W.R. 38, and cf. John D. Honsberger, *Canadian Recognition of Foreign Judicially Supervised Arrangements*, 76 C.B.R. 204, 207-08 (Can. 1990).

77. 109 U.S. 527 (1883).

tive. This important exception has been previously discussed⁷⁸ and its uncertain status in Canada has been noted. What needs to be added is that if the exception is upheld in Canada then it, together with the exception in (e), will seriously impede the recognition of foreign reorganization and similar orders in the absence of clear statutory authority.

B. *Quebec Position*

The Quebec position is substantially more territorialist than the position in the common-law provinces. The general rule is that foreign bankruptcy proceedings will not be recognized in Quebec if recognition would adversely affect the rights of local creditors.⁷⁹

1. Recognition of Security Interests

Until recently the common-law provinces followed the English conflict of laws rules governing the recognition of security interests in movables and immovables. The general rule is, and remains except where changed by statute, that in the case of goods and lands a security interest validly created and perfected under the law of the state where the collateral was located at the time of the creation of the security interest will be recognized in Canada, after as well as before bankruptcy.⁸⁰

At the domestic level, provincial law in the common law provinces and, where applicable, federal law as well, have long required perfection of security interests by registration of an appropriate document in a designated public registry office. If not perfected, the security interest is unenforceable or is deemed "void" when confronted with the conflicting interests of third parties. In the case of conditional sales of movables, where the goods were moved from the original situs into the host province, the legislation frequently required reperfecting of the foreign security interest as a condition of its recognition in the host province.

78. See *supra* notes 62-63 and accompanying text.

79. A. Bohémier, *La faillite internationale*, 50 REV. DU BARREAU 3, 61 (1990) ("En principe, la procédure étrangère ne produit aucun effet dans la province de Québec"); *Allen v. Hanson*, 16 Q.L.R. 79, 87 (Can. 1890).

80. See Jacob S. Ziegel, *Conditional Sales and the Conflict of Laws*, 45 CAN. BAR REV. 284 (1967) and Ian F.G. Baxter, *Secured Transactions and Conflict of Laws*, 3 CAN. BUS. L.J. 57 (1978-79).

Since 1967, a substantial number of the Canadian common law provinces have adopted a Personal Property Security Act based on Article 9 of the United States Uniform Commercial Code (UCC).⁸¹ The Personal Property Security Acts all contain a comprehensive set of conflict of laws rules which, for the most part, supersede the common law rules.⁸²

The Canadian Bankruptcy Act recognizes the priority of security interests in the debtor's property if the security interest has been validly created and perfected under the applicable law.⁸³ The Act does not contain its own conflict of laws rules and a court will apply the conflict of laws rules of the province where the issue is heard to determine the validity and perfection of the security interest. If collateral subject to the foreign security interest is located or deemed to be located in Canada, and arguably also where the secured party is under the court's jurisdiction, then enforcement of the security interest may be stayed by the court at the trustee's request (where the debtor has become bankrupt) or at the debtor's request (where the debtor has initiated reorganization proceedings under the CCAA).⁸⁴

2. Assistance to Foreign Bankruptcy Proceedings

Prior to the adoption of the Statute of Westminster in 1931, which eliminated the power of the British Parliament to enact legislation binding on the Dominions, Canadian courts were obliged to extend assistance to courts throughout the British

81. Such legislation is now in force in Ontario, Manitoba, Saskatchewan Alberta, British Columbia, and the Yukon Territory. Alberta and British Columbia enacted PPS legislation in 1988 and 1989 respectively and both Acts came into force in October 1990. Ontario, which was the first province to adopt a PPS Act in 1967 adopted a revised Act in 1989. See Personal Property Security Act 1989, S.O. ch. 16 (1989) (Ontario, Can.) [hereinafter Ontario Act]. See also Jacob S. Ziegel & Ronald Cuming, *The Modernization of Canadian Personal Property Security Law*, 31 UNIV. TORONTO L.J. 249 (1981) and Jacob S. Ziegel, *Personal Property Security Legislative Activity, 1986-88*, 15 CAN. BUS. L.J. 108 (1989).

82. See, e.g., the Ontario Act, *supra* note 81, at §§ 5-8, the rules in which are largely based on the comparable provisions in the 1972 revision of Article 9 of the Uniform Commercial Code.

83. Bankruptcy Act, *supra* note 5, at § 67 ("property of bankrupt"), §§ 127-32 (proof of claim by secured party), and § 136(1) (ranking of secured claims in distribution of assets).

84. Bankruptcy Act, *supra* note 5, at § 69(2)(a); Companies Creditors Act, *supra* note 32, at § 11. Staying orders under the Bankruptcy Act appear to be unusual but orders under the CCAA are granted almost automatically where the debt seeks to reorganize its business under the Act. There is very little Canadian jurisprudence on the court's willingness to issue a staying order where the collateral is not located in Canada.

Empire by virtue of section 122 of the British Bankruptcy Act 1914.⁸⁵

The Canadian Bankruptcy Act contains no provisions for extending assistance to foreign bankruptcy proceedings. However, such a requirement appeared in section 316 of Bill C-17, 1984, one of the several incarnations of the earlier attempts to introduce a revised Bankruptcy Act.⁸⁶ The omission in the existing Act is not as serious as may appear at first sight. First, in major cases involving multistate bankruptcies—government administrators have been able to work closely together even without the aid of formal statutory machinery.⁸⁷ Second, section 122 of the British Act only had a limited scope—since the House of Lords held in *Galbraith v. Grimshaw*⁸⁸ that it was only procedural in character and did not change the substantive rules for the recognition of bankruptcy proceedings in other parts of the Commonwealth.⁸⁹

3. Concurrent Insolvency Proceedings and Collaboration Among Representatives

There is no formal machinery in the Canadian insolvency legislation for collaboration between a Canadian representative and foreign bankruptcy representatives.⁹⁰ In practice such collaboration undoubtedly occurs. Harmonization in the distribution of assets among ordinary creditors may also be brought about by the operation of the hotchpot principle, viz. that a creditor in the forum must account for any monies he has recovered from the bankrupt estate in another jurisdiction. Unfortunately, as previously explained,⁹¹ there is a hiatus among the decisions with respect to whether a Canadian liquidator is entitled

85. *Re Graham*, [1928] 4 D.L.R. 375 (Sask. S.C.) and *Re Graham* (No. 2), [1929] 3 D.L.R. 353 (Sask. K.B.). Section 122 of the British Bankruptcy Act only applied to the bankruptcies of individuals and not to the liquidation of companies.

86. The federal government has indicated its willingness to deal with this and other outstanding domestic and international issues in a second round of amendments to the Bankruptcy Act once the first round of amendments has received Parliamentary approval.

87. Ziegel, *supra* note 59, at 323 n.53, citing the case concerning IOS Ltd., an international mutual fund conglomerate founded by Bernhard Cornfeld, whose collapse was a cause célèbre in the 1970s.

88. 1910 App. Cas. 508 (Eng. P.C.).

89. For the details see Ziegel, *supra* note 59, at 333-34. It is unclear whether § 426 of the British Insolvency Act 1986 has changed the position. *Id.*

90. Ziegel, *supra* note 59, 323-26.

91. See *supra* notes 71-78 and accompanying text.

to remit all or part of the proceeds from the realization of the local assets to a foreign liquidator.

All these difficulties would have been resolved under Bill C-17. Section 317(1) formally adopted the hotchpot rule, and section 316(3) of the Bill contained broad powers enabling a court to stay any bankruptcy or other proceedings in Canada at the behest of a foreign representative of the estate, and to direct a Canadian representative to transfer any property of the estate to a foreign representative.

4. Review of Antecedent Transactions

So far as Canadian bankruptcy proceedings are concerned, the position on the review of antecedent transactions is quite straightforward. The Bankruptcy Act contains explicit provisions governing the voidability of improper preferences (sections 91-97), and the reviewability of nonarm's length transactions (sections 100-01). The Canadian trustee may also be entitled to invoke provincial legislation dealing with fraudulent assignments and preferences.⁹²

The position is much more difficult where a foreign representative seeks to upset an antecedent transaction. Under the rule in *Galbraith v. Grimshaw*⁹³ it is clear that the foreign representative cannot rely on the provisions of the foreign bankruptcy law since these will only be given a prospective operation. On the other hand, the foreign representative cannot invoke the provisions of the Canadian Bankruptcy Act; only a Canadian representative has the status to do so.

Unfortunately, Bill C-17 does not appear to have addressed itself to this particular dilemma.⁹⁴

5. International Conventions to Which Canada is a Party

The answer is brief. Canada is not a party to any convention providing for the recognition of foreign insolvency proceedings. A comprehensive bankruptcy treaty was negotiated with the United States in 1979 but was never signed by the two govern-

92. The constitutionality of the provincial legislation was upheld in *Robinson v. Countrywide Factors Ltd.*, [1978] 1 S.C.R. 753.

93. 1910 App. Cas. 508 (Eng. P.C.).

94. It is not specifically addressed in the panoply of court powers enumerated in § 316(3) unless it is to be found in the catch-all power of § 316(3)(g) authorizing the court to provide "any other appropriate relief."

ments.⁹⁵ Canadian bankruptcy practitioners appear to be of the view⁹⁶ that the same goals can be achieved more easily through the adoption of common legislation in each of the participating states. The Canadian-United States experience would appear to bear this out. If Bill C-17 had been enacted, Canada would have had a comprehensive set of conflict of laws provisions following closely the comparable provisions in sections 303 and 304 of the United States Bankruptcy Code.

6. Special Problems Peculiar to Canada and Current Developments

In a short report of this character it is not possible to do justice to the special problems peculiar to Canada and current developments in bankruptcy, but the following points encapsulate some of the more important issues. Given the close business relationships between Canada and the United States and the presence in Canada of many subsidiaries of United States parent corporations, new judicial and legislative approaches are necessary to resolve the problems that arise when a parent corporation is placed in bankruptcy or has applied for a Chapter 11 order.⁹⁷ Next, Chapter 11 of the United States Bankruptcy Code casts a powerful shadow on the business relations between Canadian and United States corporations. It is so easy for a United States debtor to seek the sanctuary of Chapter 11, and the Chapter has such a wide reach, that almost any transaction with the debtor in Canada may be affected by a Chapter 11 order even though Canadian law is the proper law of the transaction. These uncertainties must give particular pause to a Canadian lender making a loan to a United States corporation secured by assets in Canada.

Third, the conflict of laws rules governing the recognition of

95. The text of the draft treaty appears in DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY, VOL. 2, App. D (1986). The background of the treaty is discussed in Honsberger, *The Negotiation of a Bankruptcy Treaty*, in MEREDITH MEMORIAL LECTURES 1985, at 287 (McGill University 1986). It appears that the draft treaty was not proceeded with because the Canadian authorities felt it desirable to await first the enactment of the new bankruptcy legislation.

96. Ziegel, *supra* note 59, at 341.

97. See R.N. Robertson, *Enforcement and Other Problems in International Insolvencies*, in MEREDITH MEMORIAL LECTURES 1985, at 266, 282-83 and by the same author, *Legal Problems on Reorganization of Major Financial and Commercial Debtors*, in CANADIAN BAR ASSOCIATION — ONTARIO BRANCH, SEMINAR ON MEGA INTERNATIONAL INSOLVENCIES, Toronto, April 5, 1983.

a receiver appointed at the behest of a secured party are seriously underdeveloped and quite unsettled even among common law jurisdictions.⁹⁸ Technically these are not insolvency problems, so long as the debtor has not been put in bankruptcy, but they are so closely related to them that modern bankruptcy legislation can no longer afford to ignore the impact of such receiverships.⁹⁹

Finally, there is the state of Canadian insolvency legislation. It is so badly dated that a mere updating of the conflict of laws rules will not suffice. The modernization and clarification of these rules must move in tandem with a revision of the whole Bankruptcy Act and related legislation or, at the very least, with the enactment of the promised but much delayed amendments to address the most urgent gaps in the Bankruptcy Act.

98. See Lawrence Collins, *Floating Charges, Receivers and Managers and the Conflict of Laws*, 27 INT'L & COMP. L.Q. 691 (1978); Jacob S. Ziegel, *Canadian Perspectives on Banking Transactions and the Conflict of Laws*, 4 BANK. & FIN. L. REV. 201, 218-21 (1990).

99. The close relationship is recognized in Bill C-22, *supra* note 15. Proposed new Part XI, adding §§ 242-253 to the Bankruptcy Act, contains reporting and supervisory provisions concerning such receivers, whether they have been appointed privately or judicially, and requires a secured party to give the debtor 10 days notice before proceeding to enforce a security interest.